(9)

No. 93-489

IN THE
Supreme Court of the United States

OCTOBER TERM, 1993

O'MELVENY & MYERS,
A LAW PARTNERSHIP,
Petitioner,
v.

FEDERAL DEPOSIT INSURANCE CORPORATION, AS RECEIVER FOR AMERICAN DIVERSIFIED SAVINGS BANK, ADC FINANCIAL CORPORATION, AMERICAN DIVERSIFIED/WELLS PARK II, AND AMERICAN DIVERSIFIED/GATEWAY CENTER,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF FOR THE AMERICAN BAR ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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INTEREST OF THE AMICUS CURIAE

The American Bar Association ("ABA") is a voluntary membership organization of the legal profession dedicated to the promotion of a fair and effective system for the administration of justice and the uniformity of judicial decisions. *See* ABA Const., art. 1, § 1.2. Since 1908, with the adoption of the original *Canons of Professional Ethics,* the ABA has taken a leadership role in legal ethics and professional responsibility through the

adoption of professional standards intended to serve as models for the states' regulation of the legal profession. The most recently adopted set of standards, *The Model Rules of Professional Conduct,* together with its predecessor, *The Model Code of Professional Responsibility*, continues to serve as the principal framework by which the several states regulate the practice of law.

The issue presented in this case directly addresses the role that the legal profession plays in the administration of justice, as a counsellor of corporations, specifically financial institutions.[1] This case concerns the liability of legal counsel when the client commits a fraud, unknown to counsel, upon counsel and third parties, and the Federal Deposit Insurance Corporation ("FDIC"), as successor to the thrift institution, sues the law firm pursuant to state law for malpractice. Under the state law upon which the FDIC's cause of action was based, legal counsel would have had a defense to FDIC's claim. The FDIC argued that the defense should be ignored, in order to maximize recovery. In response, the Court of Appeals created a federal common law rule and applied it as the rule of decision, thereby negating the state law defense.

The ABA's reason for filing an *amicus curiae* brief in this case is to address two aspects of the Ninth Circuit opinion that would have substantial adverse implications for the practice of law. The Ninth Circuit, although relying on state law to provide the basis for a tort cause of action, ruled that the identity of the plaintiff, a federal agency successor to one corporate client, should cause the Ninth Circuit to "trump" state law by creating a federal common law rule that would negate the defendant's defense under California law. There have been a substantial number of suits instituted by the FDIC and the Resolution

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[1] This brief *amicus curiae* is filed with the consent of the parties. Copies of their consent letters are on file with the Clerk of the Court.

Trust Corporation ("RTC") against lawyers who have represented savings and loan associations and commercial banks. The Ninth Circuit's ruling, if final, would have far-reaching consequences to such lawyers who believed that any malpractice responsibilities would be governed by state law.

The Ninth Circuit opinion also implies that a law firm has some sort of duty of investigation that is owed to non-client third parties. It would appear, under the reasoning of the Ninth Circuit, although the opinion is unclear on this point, that the recipient of this duty is the FDIC, or its predecessor, the Federal Savings and Loan Insurance Corporation ("FSLIC"). Such an alleged duty would come into existence only after a federal agency conservator or receiver is appointed and would retroactively change the relationship between lawyer and client.

The advice and services that legal counsel provide to their clients is governed at least partly by controlling state law, particularly when the client is chartered under state law. If, subsequent to the provision of these services, the client is thereafter placed in a federal agency conservatorship or receivership, and the otherwise applicable state law is replaced by newly created federal law, solely to maximize recovery by a federal agency receiver in a tort action against third-party professionals, the likely result would be to have a significant chilling effect on the zealous representation of clients and could even lead to those clients not being represented by legal counsel. If the potential presence of a federal agency as receiver in a case thereby could change controlling law, legal counsel would be required to provide dual or alternative and possibly even conflicting advice to corporate clients, while recognizing that the government takeover of the client could result in the removal of all defenses to a malpractice claim. This not merely could and would affect advice provided by lawyers, because of the inherent conflict of interest, but more likely would result in certain entities,

or entities in financial difficulty, not being represented at all.[2]

The ABA is therefore concerned about the threat this case presents to the system of state regulation of the bar—and to the attorney-client relationship itself—posed by selectively and retroactively imposed liability, stemming from courts, under the putative authority of federal common law. If the presence of FDIC as receiver in a suit can change the controlling law governing professional liability, counsel for financial institutions would be obliged to look over their own shoulders each time they are called upon to provide legal services. Even more constraining is the implication that legal counsel may owe a duty to constituents other than the client, constituents who, directly or indirectly, may have causes of action. This implied duty raises the specter of conflict of interest even in routine transactions. This impairs the ability of the financial institution bar to provide totally disinterested advice and to represent their clients zealously.[3]

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[2] This *amicus* brief is submitted to the Court, in part, because of the analysis by and the report of the ABA Working Group on Lawyers' Representation of Regulated Clients, *Laborers in Different Vineyards? The Banking Regulators and the Legal Profession* (Discussion Draft Jan. 1993) ("ABA Discussion Draft"). The recommendations of that report resulted in a resolution of the ABA House of Delegates adopted in February 1993. Although the report discussed primarily the administrative agencies and administrative actions instituted by them against lawyers and law firms, the report also discussed civil actions by federal agency receivers, and the duties of lawyers to investigate, including the circumstances of the instant case. The report recognized the dangers to the legal profession presented by the Ninth Circuit decision. *Id.* at 43-45, 124-31 and 186-87.

[3] Neither this brief nor the decision to file it should be interpreted to reflect the views of any judicial member of the American Bar Association. No inference should be drawn that any member of the Judicial Administration Division Council has participated in the adoption of or endorsement of the positions in this brief. This brief was not circulated to any member of the Judicial Administration Division Council prior to filing.

SUMMARY OF ARGUMENT

The Ninth Circuit did not apply—did not even cite—the leading U.S. Supreme Court cases such as *United States v. Kimbell Foods, Inc.*,[4] and *Kamen v. Kemper Fin. Serv., Inc.*,[5] and did not analyze the case in the context of the three-prong test laid out by this Court in 1979 in *Kimbell Foods*. None of the three criteria of *Kimbell Foods*, the third of which is the most relevant to the ABA, is satisfied in this case.

The third question involved in the *Kimbell Foods* test, that is, whether a federal rule of decision would disrupt commercial relationships predicated on state law, is of direct concern to the ABA because the relationship of lawyers to their clients, and the relationship of lawyers to their supervisory authority, relationships which have been in the past almost solely controlled by state law, would be disrupted by the Ninth Circuit's decision. Furthermore, as described in more detail in this brief, lawyers have assisted financial institutions to be on the cutting edge of change, in order for their financial institution clients to remain competitive. The Congress at times has been unwilling for political reasons to approve specifically such changes but has impliedly permitted them by failing to disapprove. If federal agencies which disagree with such initiatives also have the power at a later date to second guess legal advice through the invocation of federal common law, to negate defenses to malpractice actions otherwise controlled by state law, that power could inhibit zealous representation.

FDIC's contention in this and other cases, that a federal court should and can create federal common law whenever that would maximize or permit recovery in a tort claim, has no support in the Financial Institutions Reform,

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[4] 440 U.S. 715 (1979).

[5] 500 U.S. ——, 111 S. Ct. 1711, 114 L. Ed. 2d 152 (1991).

Recovery and Enforcement Act of 1989 ("FIRREA"),[6] or in any other statute, nor does it have support in any case law of this Court. This Court has limited narrowly the power of federal courts to displace state law as the rule of decision and has created through case law a virtual presumption in favor of the application of state law, not merely in diversity cases.

When civil courts have created or followed federal law in FDIC receivership cases, they have done so in recognition of quite different issues. The instant case, involving attribution of conduct by stockholders/officers/directors to a plaintiff corporation in a tort claim, does not present such an issue. Nor, under the facts of this case, are the circumstances present (as they have been in the case of FDIC purchase and assumption transactions involving commercial banks) for the creation or imposition of federal common law as the rule of decision.

Normally, the receiver of a business corporation stands in the shoes of the corporation, thereby acquiring both its rights and its responsibilities. The FDIC contends that, while it succeeds to all such rights, it bears only those responsibilities that would not bar or limit recovery in tort damage actions. The FDIC has made this maximization argument in numerous cases involving claims against lawyers. The federal courts, in general, have not accepted this argument. This Court by its ruling should reject FDIC's claim that federal courts can and should override state law whenever the state law gets in the way of FDIC recovery.

The Ninth Circuit should have applied the law of California to this case.

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[6] Pub. L. No. 101-73, 103 Stat. 183 (1989).

ARGUMENT

I. MAXIMIZING RECOVERY FOR THE FDIC IS NOT A PROPER BASIS IN LAW FOR DISPLACING PRE-EXISTING STATE LAW, AND ITS CORRESPONDING LAWYER/CLIENT RELATIONSHIPS, BY A NEWLY CREATED FEDERAL COMMON LAW

A. This Court Has Indicated That It Is Only Appropriate for Federal Courts to Create Federal Common Law When Three Specific Conditions Are Satisfied

This Court, in *United States v. Kimbell Foods, Inc.*,[7] articulated a three-prong test to be applied by a federal court, when determining whether federal common law should be applied in place of the relevant and otherwise applicable state law, as the court's rule of decision.

> [First,] federal programs that "by their nature are and must be uniform in character throughout the Nation" necessitate formulation of controlling federal rules. . . . Conversely, when there is little need for a nationally uniform body of law, state law may be incorporated as the federal rule of decision. [Second,] [a]part from considerations of uniformity, we must also determine whether application of state law would frustrate specific objectives of the federal programs. If so, we must fashion special rules solicitous of those federal interests. [Third,] [f]inally, our choice of law inquiry must consider the extent to which application of a federal rule would disrupt commercial relationships predicated on state law.[8]

None of those criteria is triggered in the instant case.

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[7] 440 U.S. 715 (1979).

[8] 440 U.S. at 728-29.

1. *Application of a Federal Rule of Decision Would Disrupt Commercial Relationships Predicated on State Law*

Turning initially to the third criterion in the *Kimbell Foods* case, it would bar the applicability of federal common law in the instant case. The relationship in this case, in part a commercial relationship, was predicated on state law. O'Melveny & Myers' principal office was in California, and it supplied legal advice to the California subsidiaries of a California thrift. Presumably, that advice was based primarily on state law, and the firm could assume, in 1985, that its professional responsibilities were governed by the law of the State of California which controlled admission, practice, supervision and discipline of lawyers practicing in California.

In January 1991, when the FDIC filed its reply brief in the Ninth Circuit, O'Melveny & Myers was advised that the FDIC took the position that a 1985 relationship was governed by federal law or federal common law.[9] How could O'Melveny & Myers in 1985 have assumed that its advice to its clients would be controlled years later by federal law, triggered by the conservatorship or receivership of the parent thrift? How could it assume that its professional responsibilities to its clients would be governed by a new federal rule, created by a court in June 1992? The answer is that this turn of events could not have been expected, and should not have been expected.

[9] In the FDIC's briefs before the Ninth Circuit, only two footnotes in its Reply Brief contended that federal common law should be created by the Court. Footnotes 17 and 18, pp. 18-19 of Reply Brief. In both of its briefs, it couched the issue, comparable to the Question Presented in its Brief in Response to Petitioner's Petition for a Writ of Certiorari to this Court, as one of whether a federal agency receiver of a thrift "stand[s] strictly in a failed bank's shoes" for all purposes. *See* pp. 40, 41 and 44 of Appellants' Opening Brief and pp. 18-19 of Appellants' Reply Brief.

The coining of federal common law in this case would disrupt professional and commercial relationships[10] predicated under state law.[11]

2. *There Is No Federal Program or Rule of Law Requiring Uniformity*

Regarding the first criterion in *Kimbell Foods,* there is no federal program involved in the instant case which by its nature must be uniform in character throughout the nation. Congress enacted in FIRREA certain provisions providing to the FDIC and the RTC access to federal courts in damage actions,[12] providing a statute of limitations,[13] describing "recoverable damages," dam-

[10] A quite relevant commercial relationship common to many practicing lawyers involves the policies issued by professional insurance carriers to lawyers and law firms. It is appropriate to assume that both premiums and coverage would be affected drastically if the decision of the Ninth Circuit in this case remains controlling law. ABA Discussion Draft at 48-53, 266-71. *See also* Jackson, *Reflections on Kaye, Scholer: Enlisting Lawyers to Improve the Regulation of Financial Institutions,* 66 So. Cal. L. Rev. 1019, 1069-72 (1993).

[11] The fact that the case is in a federal court, pursuant to specific statutory authority which deems that the matter arises under the laws of the United States, or the fact that specific types of tort claims may be assigned by a bank in receivership to a federal agency receiver under prior decisions applicable to the FDIC, does not change the nature of the underlying claim to that of a federal claim, with applicable, substantive federal law. *See Wichita Royalty Co. v. City National Bank,* 306 U.S. 103, 107 (1939), decided by this Court after *Erie R. Co. v. Tompkins,* 304 U.S. 64 (1938), which applied state substantive law, even though the case, after the receivership of a national bank, was removed from state court to federal court. *See also* the Rules of Decision Act, 28 U.S.C. § 1652, and U.S. Const. amend. X.

[12] *See* 12 U.S.C. § 1819(b)(2); 12 U.S.C. § 1441a(a)(11). Although the FDIC and RTC regularly contend that such jurisdictional provisions require that federal common law be applied, there is no case law from this Court supporting that position.

[13] 12 U.S.C. § 1821(d)(14).

ages in certain, limited agency suits against attorneys and accountants,[14] and indicating a standard of care for former officers and directors.[15] But Congress also incorporated in that connection state law when defining gross negligence and other terms.

FIRREA did not create a comprehensive statutory code for suits by the FDIC and the RTC against lawyers, and it is unnecessary for federal courts to fill in interstices by creating federal law to round out the federal program. This Court, in *Kamen v. Kemper Fin. Serv., Inc.*,[16] held that the court should look to state law as the law of decision even when a statute as comprehensive as the Investment Company Act of 1940 did not contain a provision regarding prior demand in a derivative action.

The Fourth Circuit, in an action instituted by the FDIC against lawyers, *inter alia*, pursuant to FIRREA, analyzed the *Kimbell Foods* criteria, in *FDIC v. Cocke*,[17] and found no basis for creating federal common law on the subject of adverse domination tolling the applicable state statute of limitations.[18] Such a conclusion is consistent with this Court's prior decisions regarding the law applicable to lawyers and the practice of law.[19] This Court has recognized

> that the States have a compelling interest in the practice of professions within their boundaries, and that as part of their power to protect the public health, safety, and other valid interests they have

[14] 12 U.S.C. § 1821(l). When overriding state law in FIRREA, Congress was clear about its intent. *See* 12 U.S.C. § 1821(e)(1) and (4).

[15] 12 U.S.C. § 1821(k).

[16] 500 U.S. ——, 111 S. Ct. 1711, 114 L. Ed. 2d 152 (1991).

[17] 7 F.3d 396 (4th Cir. 1993).

[18] 7 F.3d at 400.

[19] *See Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975).

> broad power to establish standards for licensing practitioners and regulating the practice of professions. . . . The interest of the States in regulating lawyers is especially great since lawyers are essential to the primary governmental function of administering justice, and have historically been "officers of the courts." [20]

3. *No Specific Objectives of a Federal Program Would Be Frustrated by Reliance on State Law*

The second prong of *Kimbell Foods* concerns the potential frustration of specific objectives of an alleged federal program. But in the federal program relevant to the instant case there is no such specific objective, unless one includes the objective of "maximizing recovery." One cannot blame a litigant, even a federal agency, for attempting to maximize its recovery, but that goal should not and, under decided cases of this Court, could not, authorize a court to ignore state law as the appropriate rule of decision.

If the FDIC, relying on *Kimbell Foods*, contends that all of the federal contacts with this matter in fact create a federal program, such is not the case for the following reasons:

a. *Three State-Chartered Subsidiaries of the Thrift, Which Themselves Are Not in Federal Institution Receivership, Are Plaintiffs in This Case*

Three of the four business plaintiffs—those most closely involved with the limited partnership, private placement transaction for which O'Melveny & Myers was retained as legal counsel—were state-chartered service corporations or partnerships to which none of the four FIRREA statutory provisions, discussed *supra*, applied.[21] These entities

[20] *Id.* at 792.

[21] *See* text at notes 12-15, *supra*. All of the operative facts of this matter occurred before FIRREA was enacted into law on August

could not be placed in a federal financial institution receivership and would not have been subject to the FIRREA provisions but rather would have been subject, if insolvent, to federal bankruptcy law. In fact, those plaintiffs have so little federal contact that there is a question as to how they properly remain as plaintiffs in this action in a federal court.[22]

b. *There Were Minimal Contacts with Federal Institutions in Receivership*

The Ninth Circuit incorrectly stated in its opinion that the FDIC, as the "receiver" of the thrift, sued O'Melveny & Myers. FDIC was merely a successor, as Manager of the FSLIC Resolution Fund,[23] to the FSLIC, and the operative facts did not occur when the FSLIC was the receiver of ADSB. FSLIC was acting as the conservator of ADSB in 1986, a different role, when it made the payments to investor/limited partners in the two partnership plaintiffs, American Diversified/Wells Park II, and

9, 1989, and the instant suit was filed before that date. We assume, however, for purposes of this brief, that the provisions of that statute apply to the parent thrift.

[22] This action was instituted in 1989, before the amendment to 28 U.S.C. § 1367, applicable to supplemental jurisdiction in actions instituted after December 1, 1990, became effective. Hence, no theory of pendant, ancillary or supplemental jurisdiction should apply. *See Aldinger v. Howard*, 427 U.S. 1 (1976), and *Finley v. United States*, 490 U.S. 545 (1989). In *Amerifirst Bank v. Bomar*, 757 F. Supp. 1365 (S.D. Fla. 1991), the court dismissed actions by the subsidiary service corporation of a thrift even though there was federal court jurisdiction over the suit by the parent thrift against former officers and directors. Claims against the officers, directors and counsel for a thrift, based on the claims of service corporation subsidiaries of the thrift, were dismissed in *FDIC v. Thompson & Knight*, 816 F. Supp. 1123, 1129 (N.D. Tex. 1993), currently on appeal to the Fifth Circuit, Nos. 93-1378 and 93-646.

[23] The FDIC was the successor in interest to assets and liabilities of the FSLIC, under the title of "Manager of the FSLIC Resolution Fund." 12 U.S.C. § 1821a(a)(1) and (2).

American Diversified/Gateway Center, which had sold limited partnerships and which had retained O'Melveny & Myers as their counsel. The settlement funds paid to the limited partner investors came from the thrift's first-tier subsidiary, American Diversified Capital Corporation —which is not a plaintiff in this case—and was paid out by plaintiff ADC Financial Corporation, a general partner in the Wells Park and Gateway Center projects.[24]

Thus, the alleged contacts of the entities in federal conservatorship or receivership with the transaction in litigation (the transaction in which O'Melveny & Myers provided legal advice) were tenuous, to say the least.[25]

[24] These facts are as described by the FDIC in Appellants' Opening Brief to the Ninth Circuit, at 9-11. The alleged damages in this case were not the damages of the investor/limited partners, who had assigned claims to the FSLIC, as conservator, but rather were the transactional costs of the FSLIC, in closing out the settlement with those investors, including the sale of real estate and the legal fees already paid to O'Melveny & Myers. *See* 969 F.2d at 752. The assignments in this case were not the typical assignments in FDIC cases, that is, not from the institution in receivership to the successor agency receiver. Rather, the assignments were from third parties, investors in third-tier subsidiary partnerships, and not persons referred to in the successor language in 12 U.S.C. § 1821(d)(2)(A)(i) (". . . all rights, titles, powers, and privileges . . . of any stockholder, member, accountholder, depositor, officer, or director of such [insured depository] institution . . . .").

[25] The Ninth Circuit did not cite its own decision in *Fidelity Financial Corp. v. Federal Home Loan Bank of San Francisco*, 792 F.2d 1432 (9th Cir. 1986), which involved a suit by a thrift holding company against the directors of the Federal Home Loan Bank of San Francisco, a federal instrumentality. Reversing the trial court on this issue, the Ninth Circuit indicated the limited circumstances in which formulating federal common law was appropriate:

> We need not reach the question of whether the [Federal Home Loan] Bank's actions measured up to a federal common law fiduciary duty, because we agree with the Bank that Fidelity had no such claim under federal common law. The in-

c. The Bases for Applying Federal Common Law in Certain Other Cases Involving the FDIC Are Not Present in This Case

The cases on which the FDIC relies for the application of "federal law" to its commercial bank receiverships involved discrete issues [26] and were based on the

stances in which federal courts may formulate federal common law are "few and restricted." *Wheeldin v. Wheeler*, 373 U.S. 647, 651, 83 S. Ct. 1441, 1444, 10 L. Ed. 2d 605 (1963). "[A]bsent some congressional authorization to formulate substantive rules of decision, federal common law exists only in such narrow areas as those concerned with the rights and obligations of the United States, interstate and international disputes implicating the conflicting rights of States or our relations with foreign nations, and admiralty cases." *Texas Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 641, 101 S.Ct. 2061, 2067, 68 L.Ed.2d 500 (1981).

792 F.2d at 1437. The Ninth Circuit also did not cite another case involving the same thrift and the same or very similar issues, decided eight months earlier in *California Union Ins. Co. v. American Diversified Savings Bank*, 948 F.2d 556 (9th Cir. 1991). The FDIC was a party to this action (referred to throughout as the "FSLIC"), but the Ninth Circuit did not accept its legal argument that there should be no attribution of conduct of the two stockholders/directors/officers to the thrift. California law was treated as controlling. 948 F.2d at 558.

[26] *See, for example, D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447, 459-62 (1942) (codified in part in FIRREA in 12 U.S.C. § 1823(e) and 12 U.S.C. § 1821(d)(9)(A)); *Campbell Leasing, Inc. v. FDIC*, 901 F.2d 1244, 1248 (5th Cir. 1990) (federal holder in due course doctrine); *FDIC v. Main Hurdman*, 655 F. Supp. 259, 266 (E.D. Cal. 1987) (assignability of tort claim by bank to the FDIC); and *FDIC v. Bank of San Francisco*, 817 F.2d 1395, 1399 (9th Cir. 1987) (collection by FDIC on letter of credit). Although FDIC has made arguments in commercial bank receivership cases seeking to expand the issues on which federal courts should apply federal common law to create uniform, nationwide law, the Eleventh Circuit, in two cases, refused to expand the list. *See FDIC v. Harrison*, 735 F.2d 408, 412 (11th Cir. 1984) (equitable estoppel applied to FDIC), and *FDIC v. Jenkins*, 888 F.2d 1537 (11th Cir. 1989) (FDIC held not to have absolute priority over stockholders of bank in receivership); *but see Gaff v. FDIC*, 919

contention that when FDIC as receiver of commercial banks entered into purchase and assumption transactions with third parties who were acquiring the deposit liabilities and assets of a bank, the transaction had to be consummated quickly, and there was insufficient time to research state law to determine the value of certain assets or liabilities.[27] Thus, to the extent uniformity was required, federal courts have created individual, uniform federal common law rules.

Here, a conservator of a thrift caused payments to be made to investors in two of the thrift's subsidiaries and then sought recovery on a tort claim against legal counsel.[28] The circumstances of transactions which led federal courts to apply a uniform rule on specific issues in FDIC purchase and assumption transactions are absent in the instant case.

F.2d 384 (6th Cir. 1990), a case involving a national bank, which did apply federal law in circumstances similar to *Jenkins*, which involved a state-chartered bank.

The banking system in this country has been a dual system, controlled by both federal law and state law. Both Congress and the courts have respected this bifurcation and have moved carefully and methodically, whether the issue was branching, exercise of fiduciary powers by national banks or mergers pursuant to the Bank Holding Company Act.

[27] This procedure, upon which the FDIC has relied, is described in *FDIC v. Bank of Boulder*, 911 F.2d 1466, 1470-71 (including footnote 3), *opinion on rehearing en banc* (10th Cir. 1990), *cert. denied*, —— U.S. ——, 111 S. Ct. 1103, 113 L. Ed. 2d 213 (1991). The procedure also is detailed in *Gaff v. FDIC*, 919 F.2d 384, 385-86 n.1 (6th Cir. 1990).

[28] There is substantial authority for the contention that federal courts should not create federal common law in tort actions arising under state law. *See Bank of America Nat'l Trust & Savings Ass'n v. Parnell*, 352 U.S. 29 (1956).

II. THE FEDERAL RULE OF DECISION CREATED BY THE NINTH CIRCUIT IN THIS CASE IS FOUNDED ON BAD PUBLIC POLICY AND WOULD UNDERMINE THE APPROPRIATE ROLE OF LAWYERS IN REPRESENTING THEIR CLIENTS

A. The Ninth Circuit's Vaguely Defined "Duty of Care," Owed by a Lawyer Not Only to a Client That Is Defrauding the Lawyer But Also to Potential Third Party Successors to the Client, Would Have a Chilling and Cost-Raising Effect on the Lawyer-Client Relationship That Would Not Be in the Ultimate Interest of the Public

The opinion of the Ninth Circuit not only discusses an alleged duty of care by O'Melveny & Myers to the third-party investors (969 F.2d at 749), an alleged duty which is not directly at issue in this case because the investors' claims were settled, but that opinion also discusses alleged duties to the federal agency receiver for the thrift (969 F.2d at 752). This duty to the federal agency receiver apparently sprang to life upon the appointment of the agency as receiver or conservator. Thus, if there can be any likelihood that a conservator or receiver could be appointed, this unborn duty must be taken into account when advice is provided.

While superficially attractive, at least from the point of view of an agency laboring under the difficulties of regulating with scarce resources, placing a lawyer under a duty to anticipate the potential concerns of regulators even when the facts known to the lawyer do not suggest any regulatory impropriety would actually be counterproductive. The inevitable effect would be to diminish the ability of the lawyer to provide the client with the progressive representation that has become so important a part of modern business lawyering.

Banks and other financial institutions in the United States operate within a highly complex framework of statutes and regulations. They also conduct their business

in a rapidly evolving and extremely competitive marketplace. Congress, in demarcating the balance of interests represented by its financial legislation, often deliberately chooses to leave open certain areas of the law for future development through experimentation and innovation.[29] While these "gaps" in the law are sometimes pejoratively labelled "loopholes," they not infrequently represent conscious, open-textured areas of legal ambiguity[30] where imaginative lawyering has enabled clients to adapt to changing market conditions.[31] Despite the vigorous protests of the regulators in some of these cases, the courts have upheld these efforts in many situations as perfectly legitimate extrapolations of prevailing law. Even where the lawyer's advice or advocacy has proven mistaken, the courts have not suggested that it should never have taken place at all. Our legal system *depends* on such progressive advocacy for its vitality.

The ABA does not of course suggest that a lawyer should ever be permitted to ignore applicable law or

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[29] For recent examples in the field of banking, *see, e.g.*, *Securities Indus. Ass'n v. Board of Governors*, 900 F.2d 360 (D.C. Cir. 1990); *Securities Indus. Ass'n v. Board of Governors*, 847 F.2d 890 (D.C. Cir. 1988); *Securities Indus. Ass'n v. Board of Governors*, 839 F.2d 47 (2d Cir.), *cert. denied*, 486 U.S. 1059 (1988); and *Securities Indus. Ass'n v. Board of Governors*, 807 F.2d 1052 (D.C. Cir. 1986), *cert. denied*, 483 U.S. 1005 (1987) (courts accepting narrow construction of the Glass-Steagall Act as a means of permitting banks to engage in a wide range of securities underwriting and dealing).

[30] This Court, in *Board of Governors v. Dimension Fin. Corp.*, 474 U.S. 361 (1986), was insistent that banking statutes be construed carefully by courts and regulators so as not to upset the delicate compromises delineated by Congress in those statutes. *Id.* at 374.

[31] Congress, of course, retains the power to override these developments where it believes them to be inappropriate, and it has proven able and willing to do so. *See, e.g.*, the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552 (1987), in which Congress overrode the effects of the ruling in the *Dimension Financial* case, *supra.*

regulations, or aid or counsel actions that the lawyer has reason to believe would be in violation of the law. But if the consequence of honest but mistaken lawyering were that the agency could subsequently argue that the lawyer had violated a duty *to the agency*, or if the agency could argue that the lawyer had a duty to ferret out fraudulent misrepresentations by the client *even where the lawyer has no reason to suspect this fraud*, a prudent lawyer would be driven to one of two courses of action: either the lawyer would simply refuse to represent the client at all, or the lawyer would ensure that any advice or assistance he or she might give, wherever there was any conceivable doubt regarding the state of the law, should always err in the direction of the views the lawyer believes the agency might take.

Neither option is appropriate to a legal system such as ours that embraces—indeed depends upon—robust and progressive (albeit responsible) legal representation of clients, whether they be individuals or corporations. The restrictive and cautious model of lawyer responsibility represented, in effect, by the duty fashioned by the Ninth Circuit in the instant case will not serve the public well in the long run.

B. Lower Courts, Taking Into Account the Broader Public Issues at Stake, Have Rightly Rejected the Efforts by the FDIC to Resort to Federal Common Law as an Expedient in Litigation

The case currently before this Court involves an attribution issue, that is, does the federal agency receiver stand in the shoes of the predecessor thrift, however muddy those shoes may be, or can the federal agency receiver shed any unwanted "baggage," including unwelcome obligations, while enforcing rights against third parties? The FDIC, however, has not been limiting its claims to a favorable federal common law merely to that issue or to the different issues described above in which federal common law was created or applied by courts primarily

to FDIC purchase and assumption transactions involving commercial banks. In the following cases, primarily involving thrifts, the agency receivers made broad-ranging claims that federal law should apply. The courts generally have not accepted the contention of the FDIC that they should apply federal law, rather than state law, as the rule of decision, to cut off or limit state court defenses of professionals.

The FDIC contended in *FDIC v. Clark*,[32] a claim against a lawyer on behalf of a defunct commercial bank, that the Colorado Proportionate Liability Statute should not apply, claiming that federal common law should "overrule" that state statute. The Tenth Circuit did not agree.[33] In *FDIC v. Ferguson*,[34] the FDIC contended that comparative and contributory negligence, defenses under Oklahoma law, should not be allowed as a defense in a suit against a lawyer for a thrift because of "public policy considerations."[35] The Tenth Circuit refused to follow the FDIC's public interest argument that those defenses should be barred.[36] The FDIC contended in *FDIC v. Cocke*,[37] a lawyer malpractice claim, that federal common law, not Virginia law, should be applied to the issue of whether the Virginia statute of limitations had been tolled. The Court of Appeals for the Fourth Circuit, citing the *Kimbell Foods* case and applying its analysis,[38] refused to accept this contention.[39]

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[32] 978 F.2d 1541 (10th Cir. 1992).

[33] 978 F.2d at 1551-52.

[34] 982 F.2d 404 (10th Cir. 1991).

[35] 982 F.2d at 406.

[36] 982 F.2d at 407-08.

[37] 7 F.3d 396 (4th Cir. 1993).

[38] 7 F.3d at 400. *See also FDIC v. Dawson*, 4 F.3d 1303, 1308-09 (5th Cir. 1993), in which the Fifth Circuit applied state law on the issue of adverse domination in an FDIC suit against the former officers and directors of a thrift.

[39] The FDIC, in its Brief for Appellee at 13, 16-21, *FDIC, as Receiver for New Bank of New England, N.A. v. Marine Midland*

The FDIC clearly does not limit its argument about creating federal common law to maximize recovery only in cases involving the kinds of factual issues that under-

Realty Credit Corp., Nos. 92-1019 and 92-1020 (4th Cir. 1993), contended in its appellate brief, that by applying federal law rather than state law, it could assign the asset component of a contract to a successor institution while retaining the liability component of the same contract in the receivership. Thus, the successor could enforce against the other contracting party the latter's responsibilities under the contract while the contracting party has access only to the receivership to enforce the bank's responsibilities under the same contract. Such a result provides a powerful incentive for the FDIC to seek to displace state law.

The RTC has made similar assertions. In its claim against a law firm in *RTC v. Latham & Watkins*, 93 Civ. 4364 (MBM) (S.D.N.Y.), the RTC contended in its Memorandum of Law in Opposition to Defendants' Motion to Dismiss the Complaint Pursuant to Federal Rule 12(b)(6), on the issue of whether the RTC properly could pursue claims of the subsidiary corporations of the thrift:

> Defendants are wrong. The RTC is not a garden-variety private corporation organized under state law to generate profits for its shareholders. To the contrary, the RTC's genesis is FIRREA, which Congress enacted.

Id. at 75. The RTC went on to argue that it is

> not bound by the formalities of state corporation law in protecting and preserving the assets of failed institutions and their wholly owned subsidiaries . . . .

Id. at 76.

The trial judge, in his ruling, did not accept this argument. Decision of Judge Mukasey, December 2, 1993, at 12-13. *Bank Lawyer Liability*, Buraff Publications, Washington, D.C., pp. C-6 - C-7 (Jan. 7, 1994). Judge Mukasey stated:

> The RTC has asserted claims in behalf not only of entities for which it has been authorized to act as receiver but also on behalf of the wholly owned subsidiaries of those institutions. The RTC has argued that the broadly remedial purpose of FIRREA permits it to do that.
>
> There is nothing in the statute that overrides the corporate form of separate legal entities or permits the RTC or this court at will to disregard the separateness of those entities. In this respect I follow and endorse Judge Leval's ruling on precisely the same point in *In re Frost Brothers Incorporated*, 91 Civ. 5244 (PNL), reported at 1992 U.S. LEXIS 18301, Southern District of New York, December 2, 1992.
>
> The practical effect of this ruling is to bar any claims asserted in behalf of Liberty Service Corporation, a wholly owned subsidiary of Columbia Savings and Loan Association, and American Capital Fidelity Corp., a wholly owned subsidiary of FarWest Savings and Loan Association.

lie the instant case and in *FDIC v. Ernst & Young*,[40] but has also made the argument in numerous other cases involving lawyers wherever application of state law would or could limit the agency's recovery.

CONCLUSION

Under the criteria of *Kimbell Foods*, and other Supreme Court authority, the Ninth Circuit should not have displaced state law by a federal common law rule of decision. There is no comprehensive federal program that must be implemented by a court with uniform federal common law.

The agency receivers are relying on *state law causes of action*, while pursuing their claims in federal courts pursuant to congressional grants of *jurisdiction*. But there are no congressional grants of *federal causes of action*,

[40] 967 F.2d 166 (5th Cir. 1992). *See also* the response of the U.S. District Court in *FDIC v. Day*, 148 F.R.D. 160, 177 n.23 (N.D. Tex. 1993), to the arguments of the FDIC about its "superpower" status:

> FDIC and its attorneys have repeatedly reminded the court of special treatment FDIC and its related agencies have received from the courts, including what have become known as the "superpower" defenses. The court recognizes that FDIC is afforded something of a special status; and the court has taken into consideration in the court's findings and conclusions the decisions that have favored FDIC in those respects. Also, the court has noted that there is a limit on how far the courts will go to further the interests of FDIC. *See, e.g., Federal Deposit Ins. Corp. v. Ernst & Young*, 967 F.2d 166 (5th Cir. 1992).

and none should be implied, merely because the federal courts have been vested with jurisdiction.

The "certainty of the law" evaporates if legal advice, and the consequences to legal counsel for providing such advice, are controlled not by state law but by whatever the FDIC urges is "the law," a law tailored only to maximizing recovery in tort actions, years after legal advice was given. Such a result could have a deadening effect on zealous representation by legal counsel and could result in certain classes of clients—those which might enter into a federal agency receivership—not being represented. On a cost/benefit basis, the risk to practicing lawyers of exposure to after-the-event, newly coined, "federal common law," might well outweigh any incentive to represent the client at all or in a manner appropriate to a dynamic legal and financial system.

Respectfully submitted,

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